

## MOLDOVAN AGRI-FOOD TRADE UNDER THE INFLUENCE OF INTEGRATION PROCESSES

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### *Abstract*

*The paper aims at the assessment of the main effects of signing the Association Agreement on the Moldovan agricultural sector, while examining its reaction, if the Republic of Moldova would have opted for its integration in the Customs Union - Russian Federation, Belarus, and Kazakhstan. During the period 2010-2013, Republic of Moldova launched a number of trade policy development initiatives in order to ensure a more facilitating legal framework for the economic and trade relations with the key external partners. An agreement on the establishment of a free trade area in the CIS was signed in this period. Similarly, Republic of Moldova started negotiating the Association Agreement with the European Union, which was signed in June this year and has as component part the Deep and Comprehensive Free Trade Agreement (DCFTA). The paper reveals that the signing of the Association Agreement with the EU could serve as instrument to stimulate the agricultural sector, but the DCFTA establishment will present some challenges, which are to be properly addressed, in order to exclude their turning into risks.*

*Key words:* agri-food trade, customs union, export, free trade agreement, import

### INTRODUCTION

The negotiation, initialing and preparation for signing the Association Agreement (AA) has increased the concerns for the agricultural sector, particularly the way in which it will meet the challenges of symmetric liberalization of foreign trade with European Union countries and Turkey [1]. The significance of these measures is more important than trade relations facilitation, which aim at speeding up the structural reforms and overcoming the transition stage of the national economy. At the same time, AA is as important for the national economy, as much responsibility is required on behalf of the national authorities and the entire civil society for its proper implementation. Along with the intensification of the liberalization process, many sectors of the economy will face a number of challenges to increase the competitiveness and ensure resistance to foreign competition. One of the most threatened sectors, which was granted special importance in the negotiations is agriculture, which continues to play an important role in the national economy.

The Customs Union (CU) implies a higher

level of integration compared to FTA. Besides the maximal elimination of tariff and non-tariff barriers to trade, the participants to the agreement that usually are geographically adjacent countries, shall adopt a common customs tariff, reaching a consensus on the degree of protection of all sectors. Therefore, the negotiation and implementation of a CU involves increased efforts in terms of time, financial resources and political concessions. By adhering to CU, a state loses a large part of its autonomy to develop its trade policy [2]. The Republic of Moldova was included in the EU list of countries benefiting from preferences since the mid-90s, and since 2008, it benefits from autonomous trade preferences. However, the opportunities offered by this system are not fully exploited to the existing potential and the rates offered for a large part of agri-food products remain unrealized, except for some tariff headings, such as: corn, wheat, barley, wines. Moreover, some products such as those of animal origin cannot be exported to this market [3].

### MATERIALS AND METHODS

The objective of this study is to assess the main effects of signing the Association

Agreement over the Moldovan agricultural sector, while examining its reaction, if the Republic of Moldova would have opted for integration into the Customs Union - Russian Federation, Belarus, and Kazakhstan. During the investigations, the following study methods were used: statistical method, which involved researching a larger number of observations, analysis of growth rates of the economic indicators; theoretical synthesis, formulation of judgments. The information was gathered from sources of the World Bank, World Trade Organization UNCTAD, WITS, and National Bureau of Statistics of the Republic of Moldova.

## RESULTS AND DISCUSSIONS

The agri-food sector traditionally plays an important role in negotiating the preferential trade agreements. This can be explained by the food security concerns of the public authorities of the country, welfare of the rural population, and in particular, in developed countries, the impact of imports of certain agri-food products could have on consumer safety.

In the Republic of Moldova, the situation is quite challenging. Compared to other countries in the region, the contribution of agricultural sector to GDP growth is significant. According to the National Bureau of Statistics, in 2011<sup>8</sup>, the share of agricultural sector (added value) in GDP exceeded the level of 12% of GDP, and food and beverages industry - constituted about 4.5% of GDP and more than a quarter of the added value created by the industry. The value added in industry was lower than in the agricultural sector, about 11.4% of GDP (Fig.1).

The contribution of agriculture to GDP growth in the Republic of Moldova is significant, although decreasing in recent years. Similarly, despite the high share in GDP, compared to the Central and Eastern Europe countries, the added value created in the sector reported per capita in the Republic

of Moldova is much lower.

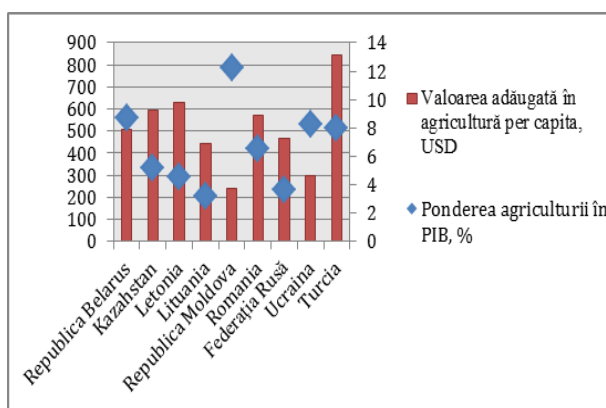


Fig.1. Share of agriculture in GDP and added value created in the sector per capita, 2011

Source: According to UNCTAD data

According to the World Bank data, in regional aspect, the Republic of Moldova is among the countries with the lowest level of labor productivity (Table 1). Quantified as the ratio of value added per worker, expressed in USD in 2005 prices, the labor productivity in the sector amounted to USD 1,884.3, much smaller than in the countries from the region, let alone the European average.

Table 1. Labor Productivity in Agriculture

	EU	Romania	Turkey	RM	Russia	Kazakhstan	Belarus
Labor Productivity, USD (2005=100%)	18380,4	8067,8	6597,8	1884,3	5968,6	3532,5	7845,5

Source: According to the World Bank data.

Low productivity can be explained by several reasons:

- Farm structure, concentrated mainly in small households. According to 2012 data, about 50.8% of agricultural production was obtained in population households;
- Weak farm endowment with technical equipment, the agricultural machinery owned by farmers being most often morally and physically obsolete.
- Low level of education of the population employed in the sector, which adversely affects the structural transformation process and technological progress.
- Poorly diversified structure of the sown areas etc.

<sup>8</sup> The last year for which annual data regarding GDP resources is available and the agricultural sector was not affected by natural disasters was taken into account.

### **Balance of the risks and integration options opportunities of the Republic of Moldova for the agricultural sector**

In November last year, the Republic of Moldova initialed the Association Agreement with the European Union, which directly provides for the creation of a Deep and Comprehensive Free Trade Area (DCFTA) between the parties, and will try to continue the assessment of the main risks and opportunities for the local agri-food sector. Also in this context, the potential effects shall be appreciated that may bring a deeper economic integration in the CIS - joining the Customs Union - Russia, Belarus, and Kazakhstan.

#### ***Impact of the DCFTA with the European Union***

Currently, the foreign trade between the Republic of Moldova and the European Union takes place within the asymmetric preferential trade regime, meaning “0” tariff for agri-food products exported to these destination, with some exceptions:

- products of animal origin, cereals, white sugar and grape wine that are allowed to be exported within the established tariff quotas;
- fruits and vegetables exempted of VAT payment at import. At the same time, many of these products are subject to a minimum price of entry at import [4].

Several previous studies indicate that even in these conditions, the local exporters cannot fully benefit from the existing preferential regime. The biggest constraint in this regard is their low capacity to adjust to the European quality standards. Although for many years, the Republic of Moldova has started upgrading the quality infrastructure; this process is costly and time consuming.

Including due to this reason, the agri-food industry has been given a special role in negotiating the agreement, both regarding the import in the Republic of Moldova and in the EU. Thus, according to the Association Agreement, Title V - dedicated to the trade and trade-related areas and annexes aimed at this title, by signing this Agreement, the parties will grant each other free market access for products originating in the

Republic of Moldova and the EU, with some exceptions.

The European Union will maintain certain tariff and non-tariff barriers for certain products:

- a)tariff rates - tomatoes, garlic, grapes, apples, plums, grape juice;
- b)customs duty without VAT - artichokes, cucumbers, zucchini, oranges, clementine, mandarins, pears, apricots, cherries, nectarines, peaches, grape etc.

The Republic of Moldova will reserve the right to gradually liberalize the import of products according to some predefined schemes, in different terms, depending on the sensitivity of the sector.

In this way, some instruments can be distinguished in this respect:

1. reducing tariffs in three annual steps, starting from 1 January of the year following the entry into force of the Agreement – melted cheeses, other than grated or powdered like;
2. reducing tariffs in 5 annual steps, starting from 1 January of the year following immediately after the entry into force of the Agreement - fresh cheese (including whey cheese) unfermented and curd, tomatoes, onions, zucchini, carrots, cucumbers, sweet peppers, nectarines, strawberries, effervescent wine and grape must, etc.;
3. reduction of tariffs in 10 annual steps, starting from 1 January of the year following the entry into force of the Agreement - milk and milk cream, concentrated or with added sugar or other sweetening matter, cherries, canning and meat products, offal of turkeys, uncooked beef and others;
4. reducing tariffs, starting from 1 January of the fifth year after the entry into force of the Agreement – fresh, refrigerated or frozen eatable pork offal, grapes, apples, peaches, plums (Association Agreement between the European Union and the European Atomic Energy Community and their Member States, of the one part, and the Republic of Moldova, of the other part).

In addition to these particular issues, based on this Agreement, "Parties shall commit themselves to enhance the cooperation and good neighborly relations, including cooperation in the development of projects of mutual interest, in particular those aimed at preventing and combating corruption and criminal activities. These commitments are a key factor in the development of relations and cooperation between the Parties and contribute to the regional stability and peace.

In fact, this agreement represents a complex reform agenda for the Republic of Moldova in key areas to ensure the functioning of the economy according to the principles of market economy. The document will compel the local authorities to promote the necessary reforms in several areas: justice, public administration, competition, consumer protection, statistics, public finance management, industrial policy, corporate governance, energy infrastructure, transportation, quality, social policy, etc.

If these reforms are not be promoted by the public authorities, business environment and society as a whole, the agreement could have a profound negative impact on the agri-food sector, which will produce chain effects on other areas - employment, standards of living of the population, public finance, etc.

Liberalization of imports of agri-food products in the European Union and Turkey would mean the elimination of import customs tariffs, which would correspond to a reduction in the price of imported goods by about 10 % within maximum 10 years. According to the WTO data, in 2012, the simple average of MFN tariff in the Republic of Moldova for this product category was of 10.5%. Based on separate categories, the simple average tariff was of: 14.7% for animal products, 12.8 % - fruits and vegetables, 10.2 % - cereals and cereal products, 13 % - beverages and tobacco. In particular for wines, for one liter of imported wine, a duty of 0.5 euro is levied etc.;

Although competitive pressure will bring benefits to the local consumers, this might also influence their income levels, given the high level of employment of the population in

agriculture. Removal of any protection tools for this sector without increasing its immunity could cause higher unemployment and relatively low qualifications and reduced training of the workers could create problems in their reorientation towards other sectors.

At the same time, the correct and responsible promotion of the reform program could generate multiple opportunities for the sector:

1. Creating an equitable business environment and a functioning market with fair competition rules;
2. Increased foreign investment in the sector and its modernization;
3. Reducing the technical barriers and diversification of the range of products exported to this market;
4. Increasing export activity of the local entrepreneurs, enhanced by a regulatory framework of the long-term predictable trade relations;
5. Development of the entrepreneurial culture following the intensification of trade relations with economic partners at a more advanced stage of development.

#### ***Impact of a potential membership in the Customs Union***

As an alternative to creating a DCFTA with the European Union, we considered appropriate the assessment of the effects that could be generated by the accession of the Republic of Moldova to the Customs Union - Russia, Kazakhstan, and Belarus. Or even now, this issue is one that causes many discussions.

The trade regime with the current members of the Customs Union enjoyed a preferential treatment within the CIS, even since the country's independence. Since 2013, the trade relations with these countries are conducted within the multilateral agreement on the creation of a Free Trade Zone in the CIS, which was signed in 2011.

This agreement replaced the multitude of bilateral free trade agreements between the countries, establishing a single regulatory trade framework for all Member States. This ensures, to a great extent, the elimination of any kind of mutual trade barriers, although even within this, some tariff barriers have

been preserved, the most relevant in this respect being the export customs duties.

Unlike the commercial relations with the Western partners, the preferential trade regime with the member countries of the Customs Union is symmetrical, which implies free access to mutual markets.

In this context, according to the existing empirical evidence, it is unlikely that the adherence of the Republic of Moldova to this structure could create new trade flows in the mutual trade - a term defined in the literature as trade creation effect.

Indeed, the Republic of Moldova has a relatively higher specialization in the agricultural sector compared to the Eastern partners than the Western partners, but those advantages that could be provided by a preferential trade regime for enhancing the bilateral trade flows most likely have been used by now.

Table 2. Comparative aspects on MFN tariff rate in the regional profile, %

Country	All products	Agri-industrial products	Industrial, non-agricultural products
Republic of Moldova	4,6%	10,5%	3,7%
Belarus	9,7%	13,4%	9,1%
Kazakhstan	9,5%	13,4%	8,8%
Russian Federation	10,0%	13,3%	9,4%
European Union	5,5%	13,2%	4,2%

Source: According to World Trade Organization data.

About 38 % of agri-food products traded outside the Republic of Moldova is exported to the Customs Union market. This is an exclusive market for the sale of some plant and meat products. And joining the Customs Union involving immediate abolition of controls at the internal borders, could contribute to the facilitation of trade in these product categories. Similarly, elimination of export duties of the member countries for various fuels, especially for the Russian natural gas, could reduce the costs for farmers.

However, if the Republic of Moldova accedes

to the Customs Union, certain costs that would result from this process should be taken into account.

-First of all, considering that joining the Customs Union would mean a common customs tariff and trade regime, the CU membership is incompatible with DCFTA, which the Republic of Moldova intends to sign with the European Union. Similarly, it could most likely have the effect of non-renewal of autonomous trade preferences granted by this, which would significantly affect exports of agricultural products on the western market. In this way, if currently, with certain exceptions, within the autonomous trade preferences, the exports of agri-food products enjoy free access to the EU market, then the cancelation of the trade preferences would mean imposing on Moldovan products entering the EU market an average tariff of about 13.2 % (Table 2);

-Exports of agri-food products in CU reflect a high degree of geographical concentration, this increasing the volatility of exports, and sector activity to various external shocks. And as shown by the experience of 2006, such shocks can sometimes have fatal consequences on some sub-sectors of agriculture and food industry;

-The reduction of productivity in the sector, as a result of the increase in customs tariffs for industrial products, including capital imported from the third countries, so necessary for the technical endowment of the branch. It's about weak entrepreneurial culture and production organization as well as technical endowment of agricultural enterprises and farms that are reflected in the low productivity obtained;

Risk of delaying the promotion of some reforms necessary for the business development in general. fragmented.

## CONCLUSIONS

The dilemma between East and West for the Republic of Moldova is a topic that has seen many debates in recent years. Currently, the Republic of Moldova is on the eve of signing a Deep and Comprehensive Free Trade Agreement with the European Union that will

put on an equal footing two important economic partners, being able to exploit the opportunities offered by the preferential trade arrangements and close cooperation with both.

At the same time, we have addressed this issue in the context of agri-food sector development prospects, considering it as still being an important one, or neglecting it could have adverse effects on the branch if the potential risks are not acknowledged.

Agriculture is one of the sectors that still provide a major contribution to ensuring the growth of the national economy. At the same time, in recent years, its evolution indicates a relatively high volatility, which also causes large oscillations in economic growth rates.

For this reason, but also due to the importance of this sector to ensure development of rural areas and the country's food security, the agricultural development must have a special place in the economic policy of the state.

Regeneration of the sector and increase in its competitiveness abroad requires some radical measures that would produce changes in its structure. The signing of the Association Agreement with the EU could serve as instrument to stimulate this process, but the DCFTA establishment will present some challenges for the sector, which are to be properly addressed, for this not to turn into risks.

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